OFFICES OF THE COUNTY EXECUTIVE

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County Executive

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March 19, 2012

Members of the Montgomery County Council

I am pleased to present to you the Quarterly Report of the Montgomery County Employees' Retirement System ("ERS") for the quarter ended December 31, 2011. This quarterly report is designed to assist you in understanding the current status of the ERS. This report was prepared pursuant to the provisions of the Montgomery County Code.

History

The Employees' Retirement System was established in 1965 as a cost-sharing multiple-employer defined benefit pension plan providing benefits to the employees of Montgomery County and other agencies or political subdivisions who elect to participate. The System is closed to employees hired on or after October 1, 1994, except public safety bargaining unit employees and employees who elect to participate in the Guaranteed Retirement Income Plan. There were approximately 5,400 active members and 5,800 retirees participating in the ERS as of December 31, 2011.

Performance Results

The total return achieved by the ERS assets for the quarter was a gain of 4.71%, 112 basis points behind the 5.83% gain recorded by the policy benchmark. For the one year period ending December 31, 2011 the ERS' gross return (before fees) was a gain of 4.63%, 72 basis points behind the 5.35% return recorded by the policy benchmark. The one-year gross return places the ERS' performance in the top 10% of the universe of comparable pension funds constructed by the Board's consultant, Wilshire Associates. Our annualized performance of 13.26% for the three-year period, and 4.02% for the five-year period ranked in the top 10% of the universe. The asset allocation at December 31, 2011 was: Domestic Equities 24.7%, International Equities 15.9%, Fixed Income 26.1%, Inflation Linked Bonds 11.4%, Commodities 4.9%, Private Equity 7.5%, Private Real Assets 4.9%, Opportunistic 3.7%, and Cash 0.9%. We estimate that the funded status of the ERS was 76.1% as of December 31, 2011, a slight decrease from the June 30, 2011 level. The actual funded status will be affected by the ERS' membership experience, as well as demographic and economic changes and may be higher or lower when calculated by the actuary during the next valuation.

Major Initiatives

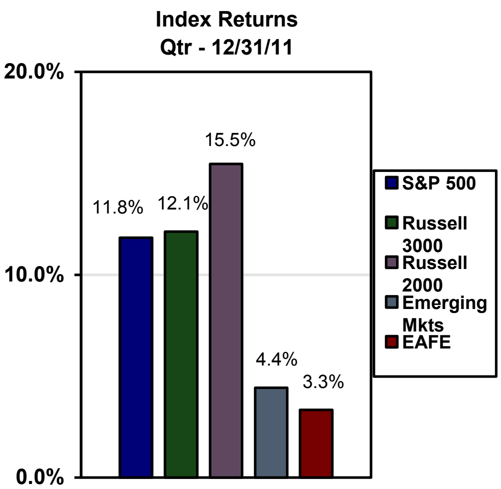
The Board approved the following investments during the quarter: Opportunistic - $27,000,000 in GMO's Mean Reversion; Private Real Assets - $20,000,000 in Carmel Partners Investment Fund IV, L.P and Public Equities - $70,000,000 in Los Angeles Capital Management's US Large Cap Active Extension and $105,000,000 in Sands Capital Management's Large Cap Growth. Staff continues to review opportunities within the private real assets, private equity and opportunistic allocations.

Capital Markets and Economic Conditions

Fourth quarter employment data indicated that the labor market is showing signs of recovery as initial jobless claims fell below 400,000 per month by the end of the quarter and the unemployment rate fell to 8.5%, the first reading below 9.0% since March of 2009. The U.S. economy grew at an annualized rate of 2.8% last quarter, up from the 1.8% reading in the 3rd quarter. The Federal Reserve maintained its target for the Fed Funds rate within the 0%-0.25% range and announced that interest rates are expected to stay low until at least 2013. Core inflation rose slightly in the quarter, with a year-over year inflation rate of

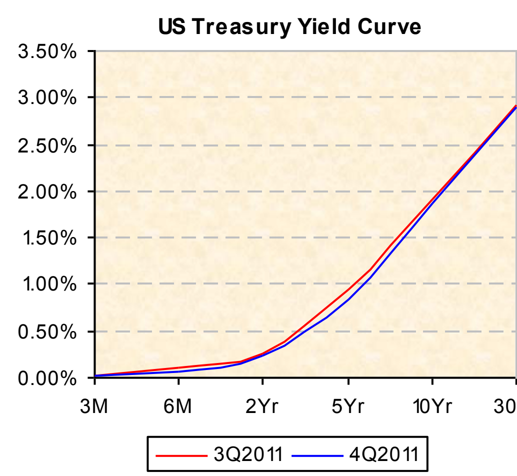
2.2% as of quarter end. Housing data remains depressed with the Case/Shiller Index showing that prices continued to fall due to lack of demand and the increased supply from foreclosures. The Institute for Supply Management's manufacturing index continues to come in above 50 (readings above 50 indicate the sector is still expanding), but falls short of the robust levels seen earlier in the year. Outside of the U.S., European markets rallied as leaders took steps to solve the continent's debt crisis, and emerging markets rose despite slowdowns in China and Brazil as well as increased inflationary fears.

Public Equity Markets: The U.S. equity markets advanced during the quarter as the economy improved and investor confidence supported risk assets. High volumes of dividend growth, share buybacks, and M&A activity were observed during the quarter. In contrast to the previous quarter, all domestic indices rallied strongly, as shown in the chart to the left. Smaller capitalization (as represented by the Russell 2000 Index) stocks outperformed their larger counterparts. All sectors of the S&P 500 were in positive territory, led by cyclical sectors such as Energy, Industrials, and Materials. Our combined domestic equity performance was a gain of 12.25%, outperforming the 12.12% gain recorded by the Russell 3000 benchmark.



International markets recouped part of their deep losses from the previous quarter however, they lagged the U.S. markets as the unresolved sovereign debt crisis and the probability of Europe entering a recession continued to weigh on these markets. Developed markets, as measured by the MSCI EAFE Index, rose 3.33% during the quarter benefiting from improving global economic data, led by the U.S. and China. Emerging Markets gained 4.42% during the quarter outperforming their developed counterparts, with the majority of markets rallying. Among the BRICs, Brazil, Russia and China rallied while India performed poorly on inflation fears. Our combined international equity performance was a gain of 3.19% for the quarter, underperforming the 3.72% gain recorded by the MSCI ACWI ex-US Index due to stock selection in Europe (UK) and Japan, and positioning in Japan and UK.

Fixed Income: U.S. Treasury yields ended the quarter where they started but experienced significant volatility, primarily on the longer end of the curve, during that time. The 30-year Treasury began the quarter at 2.92% and rose to as high as 3.46% in October before falling back down to 2.90% by quarter end. The move higher was due to moderately stronger economic data and progress in solving the European sovereign debt crisis. However, the impact of the Fed's "Operation Twist" (a plan to sell short-term notes and move assets into long-term Treasuries) and strong investor demand for high quality, liquid assets brought yields back down. For the quarter, the 2-year Treasury yield was unchanged at 0.24%, while the 10- year Treasury yield fell to 1.88%, down 4 bps causing the yield curve (shown in the chart to the right) to flatten slightly. At year end, the 5-year closed below 1%, the 10-year below 2% and the 30-year dropped below 3.00%. All are at or near historically low levels. Credit spreads tightened over the quarter resulting in both investment-grade and high yield credits outperforming relative to Treasuries. However, credit spreads ended the year wider than the beginning of the year. For the quarter, the Merrill Lynch High Yield Master II Index returned 6.19%, the Barclays Aggregate Bond Index returned 1.12% and the Barclays Long Government/Credit Index rose 2.57%. Our combined fixed income performance for the quarter was a gain of 3.74%, outperforming the custom benchmark which returned 3.58%. Our global inflation-linked bond portfolio, combined with the portable alpha overlay, returned 5.39% for the quarter, compared to the 5.10% gain recorded by the benchmark.

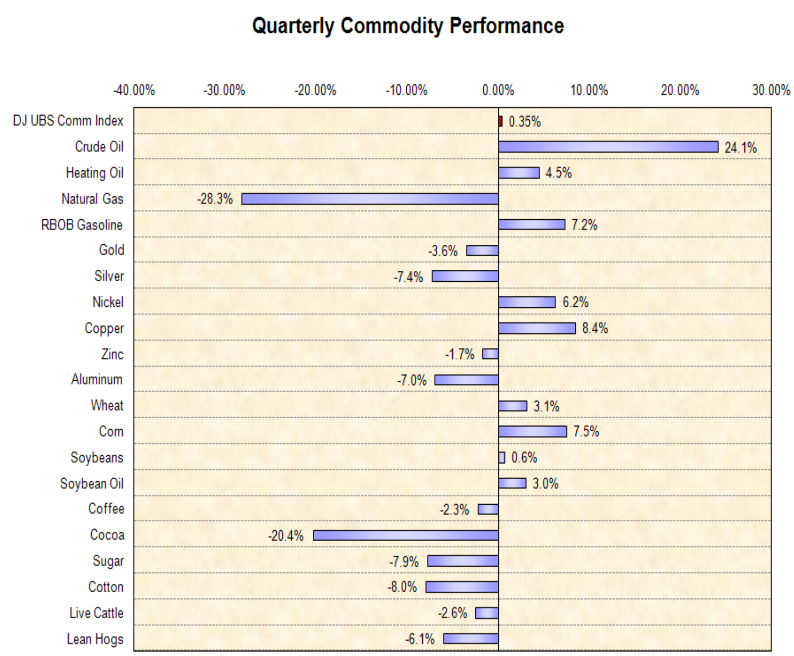


Opportunistic: Hedge funds concluded a challenging 2011 with negative performance for the quarter and the full year. 2011 marks only the third calendar year that the HFRI Index had negative performance since its inception in 1990, but the second time in the last four years. Risk aversion remained high during the quarter with the Eurozone debt issues continuing to dominate investor sentiment. Global macro and relative value strategies were the only positive performers for the quarter. Global macro strategies benefited from market moving events such as the eurozone debt crisis and central bank actions. Equity strategies were the weakest area of performance this quarter and for all of 2011. Throughout the year, equity markets were driven by macro issues, which overshadowed strong corporate earnings and an improving U.S. economy. Equity sector performance showed a wide variance of returns and overall performance was driven by weakness in energy, emerging markets and fundamentally oriented strategies. However, certain sub-strategies posted 2011 gains, including technology, healthcare and short biased. The return of the opportunistic allocation was a gain of 0.49%, outperforming the 39bps decline of the benchmark.

Private Equity: The fourth quarter showed a significant recovery in buyout and venture capital activity following a slower third quarter. Pricing remained robust and generally above its 10-year average, though still well below the peak valuations reached in 2007. Overall, 2011 was a strong year for fundraising, with U.S. fundraising up 42% versus the prior year and global fundraising up 67% over the same period. During the quarter, our private equity managers called a combined $12.5 million and paid distributions of $5.4 million. Our current allocation to private equity is 7.5%, with a market value of $208.6 million. From its 2003 inception through September 30, 2011, the private equity program has generated a net internal rate of return of 5.6% versus a 3.3% return for the dollar-weighted public market equivalent (the Russell 3000 Index plus 300 basis points).

Private Real Assets: Global real estate activity was up slightly over the prior year, as robust increases in U.S. real estate activity were offset by slower rates of increase in Europe and Asia. The uncertainty surrounding the European debt crises slowed activity worldwide in the second half of the year. U.S. commercial real estate prices continued to rise during 2011 and investors expanded their activity outside of the major cities. Multifamily properties remained most compelling to investors, followed by office and retail assets. In the energy sector, investment in oil and other energy liquids continued to be favorable relative to natural gas. Oil prices have remained high due to tensions with Iran, while natural gas prices have been weak due to above average temperatures in much of the U.S. this winter. During the quarter, our managers called a total of $17.8 million and paid distributions of $3.8 million. Our current allocation to private real assets is 4.9%, with a market value of $136.0 million. From its 2006 inception through September 30, 2011, the private real assets program has generated a net loss of 6.6% versus a 9.0% loss for a broad real estate price index (the Moody's/REAL U.S. Commercial Property Price Index).

Commodities: The DJ UBS Commodity Index was slightly up in the fourth quarter led by the Energy and Grains sectors. During the quarter, Crude Oil rallied on geopolitical concerns (primarily Iran), and improving economic data in the U.S. On the other hand, Natural Gas prices continued to weigh on the Energy sector, impacted by oversupplies and warmer-than-normal weather conditions. Corn and Sugar prices advanced on an improving demand outlook for energy (which in turn increases biofuel producers' margins). Precious metals declined as investors moved into risk assets and focused on the recovery of the U.S. and European equity markets. During the quarter, our commodities portfolio advanced 0.71%, outperforming the 0.35% gain recorded by the DJ UBS Commodities Index.



Additions

The primary sources of additions for the ERS include contributions from members and employers and investment income. The following table displays the source and amount of additions for the quarter ending December 31, 2011 and fiscal year-to-date.

Employees' Retirement System
Contributions and Investment Income (millions)

	Qtr 12/31/2011	Fiscal YTD
Employer Contributions	$ 27.3	$ 54.6
Member Contributions	5.7	11.3
Net Investment Income	120.9	(62.3)
	$ 153.9	$ 3.6

Deductions

The deductions from the Employees' Retirement System include the payment of retiree and survivor benefits, participant refunds, and administrative expenses.

Employees' Retirement System
Deductions by Type (millions)

	Qtr 12/31/2011	Fiscal YTD
Benefits	$ 49.3	$ 98.7
Refunds	1.5	3.0
Administrative Expenses	0.8	1.6
	$ 51.6	$ 103.3

Outlook

The outlook for the global economy is slow growth with a potentially significant differentiation between the strongest and weakest economies. Macro conditions will continue to dominate investor sentiment including the turmoil in the Middle East which remains high resulting in higher oil prices that may constrain global growth.

The U.S. economy is recovering and the emerging markets continue to grow, albeit at a slower pace, however the conditions in Europe may slow global economic growth. The strength in the U.S. economy has been fairly broad, and while growth may not be strong, it appears that a double-dip recession has been prevented. However, the massive levels of monetary and fiscal stimulus supporting the U.S. economy cannot be sustained indefinitely. Emerging market economies face headwinds but are expected to expand at a faster pace than advanced economies due to the growth of the emerging middle class. Economic growth in China, the world's growth driver, is slowing, even as inflation worries weigh on markets. The challenge for emerging market central bankers is to remain ahead of the inflationary pressure. Financial tensions in peripheral Europe remain high, given the lack of decisive action to deal with the solvency concern. Recent European Central Bank actions appear to have alleviated systemic risk but austerity measures and large budget deficits may lead to a European recession.

Sources: Bloomberg, Northern Trust, MSCI, S&P, Pyramis Global Advisors, FRM, Wilshire Associates, Bridgewater, JP Morgan, BlackRock, PE Hub, Private Equity Analyst, Pitchbook, Real Capital Analytics, RE Alert, Schroder, Oil & Gas Investor.

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF PLAN NET ASSETS
December 31, 2011

Assets		
Equity in pooled cash and investments	$	3,466,840
Investments:		
Northern Trust		2,767,822,008
Aetna		16,137,672
Fidelity - Elected Officals Plan		363,551
Fidelity - DRSP		10,249,228
Total investments		2,794,572,459
Contributions receivable		5,072,831
Total assets		2,803,112,130
Liabilities		
Benefits payable and other liabilities		5,535,669
Net assets held in trust for pension benefits	**$**	**2,797,576,461**

EMPLOYEES' RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET ASSETS
December 31, 2011

	Quarter	Fiscal YTD
Additions		
Contributions:		
Employer	$ 27,312,243	$ 54,624,486
Member	5,674,950	11,349,900
Total contributions	32,987,193	65,974,386
Investment income	124,576,155	(51,688,183)
Less investment expenses	3,651,625	10,622,091
Net investment income	120,924,530	(62,310,274)
Total additions	153,911,723	3,664,112
Deductions		
Retiree benefits	36,332,030	72,664,059
Disability benefits	10,908,080	21,816,159
Survivor benefits	2,110,341	4,220,681
Refunds	1,490,574	2,981,147
Administrative expenses	806,658	1,613,315
Total deductions	51,647,681	103,295,361
Net increase (decrease)	**102,264,043**	**(99,631,249)**
Net asset held in trust for pension benefits		
Beginning of period	**2,695,312,418**	**2,897,207,710**
End of period	**$ 2,797,576,461**	**$ 2,797,576,461**